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From Hamiltonian Dreams to Maastricht Reality: "Whatever It Takes" 2.0?*

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Summary. During the COVID-19 pandemic, the institutional architecture of the euro area has been tested again. While some authors argue that European policy makers have learnt from their economic policy mistakes during the sovereign debt crisis, or even talk about the "European Hamiltonian moment", the opportunity to fundamentally strengthen the institutional foundations of the currency union has been missed again. While public attention has been focused mostly on the creation of the so-called "Next Generation EU" (NGEU) fund, it was the ECB that quietly performed the key role of crisis manager, despite criticism of a weak initial crisis response and botched communication. Based on the synthetic framework of the classical integration theories, the principal-agent model and new intergovernmentalism, the ECB's pandemic crisis response could be interpreted as its second "whatever it takes" moment.
Keywords: Economic and Monetary Union, COVID-19 pandemic, European Central Bank, International Monetary Fund, European Stability Mechanism, Crisis Management Mechanism, Pandemic Emergency Purchase Program, Next Generation EU.

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Nuo hamiltoniškųjų svajonių iki Mastrichto realybės: „išsaugoti bet kokia kaina“ 2.0?

Santrauka. COVID-19 pandemijos metu euro zonos institucinės architektūros atsparumas buvo patikrintas dar kartą. Nors kai kurie autoriai teigia, kad Europos Sąjungos sprendimų priėmėjai pasimokė iš ekonominės politikos klaidų, padarytų skolų krizės metu, ar net teigė, kad išaušo „hamiltoniškoji aušra“, galimybė reikšmingai sustiprinti euro zonos institucinius pamatus ir vėl buvo praleista. Nors viešojoje erdvėje visas dėmesys buvo skirtas „Kitos kartos ES“ fondo sukūrimui, Europos centriniam bankui (ECB) vėl teko svarbiausias krizės valdymo vaidmuo, nors jis buvo kritikuotas dėl neva vangaus pradinio atsako į krizę ir prastos komunikacijos. Naudojantis sintetiniu teoriniu modeliu, paremtu klasikinėmis integracijos teorijomis, nagrinėjamas antrasis esminis istorinis momentas, kai ECB, nepaisydamas kainos, pandemijos metu padarė viską, ko reikėjo, siekiant išsaugoti euro zoną.

Reikšminiai žodžiai: Ekonominė ir pinigų sąjunga, COVID-19 pandemija, Europos centrinis bankas, Tarptautinis valiutos fondas, Europos stabilumo mechanizmas, krizės valdymo mechanizmas, specialiosios pandeminės pirkimo programos, Kitos kartos ES programa.

Introduction

The COVID-19 pandemic found the euro area unprepared. Its economic governance framework remained unfinished, and some member states had not fully recovered from the devastating sovereign debt crisis. At that time, European heads of state or government (European policy makers) developed a crisis management mechanism underpinned by policy of conditionality: cheap loans from the newly created European Stability Mechanism (ESM, the euro area’s regional lender of last resort for sovereigns) have become available in exchange for fiscal consolidation and reforms. The durability of this mechanism, by and large, relied on the active role of the ECB in the sovereign debt markets and its commitment to do “whatever it takes” to preserve the euro.

At the start of the pandemic, it appeared that European policy makers were heading for a disaster. Trade barriers for medical equipment started to build up amid significant medical uncertainty and lockdowns. At the same time, while yield spreads started to widen, ECB President Christine Lagarde doubled down by stating that it was not the ECB's task to close the spreads.[1] This caused an even more pronounced panic in the sovereign debt markets and started to look increasingly like a perfect storm of two crises: pandemic and sovereign debt.

It took a couple of days for the ECB to come up with a strong reaction to contain rising tensions in the sovereign debt markets by launching a significant 750-billion-euro Pandemic Emergency Purchase Programme, later expanded in several rounds in the course of 2020, adding up to 1.85 billion euro (on top of the previous active asset purchase programmes). Some commentators even called this a U-turn by the ECB.[2] After the announcement was made late in the evening, Lagarde issued an additional public statement stating that there were no limits to the ECB's commitment to the euro.[3] This technical aspect should not be underemphasised, having in mind the predefined limits applied in the previous asset purchase programmes.

In this context, during the initial phase of the pandemic European policy makers were busy with national measures to contain the spread of the virus. In addition, all euro area governments announced massive fiscal packages at the national level to contain the negative economic effects caused by the unprecedented decision to basically stop contact-intensive economic activity. At the same time, it took more than two months for the French-German proposal on joint fiscal action at the European Union level,[4] and almost half a

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1 Ch. Lagarde, "Introductory statement to the press conference," 12 March, *ECB*. Accessed October 24, 2021, https://www.ecb.europa.eu/press/pressconf/2020/html/ecb.is200312~f857a21b6c.en.html

2 L. Bonatti and A. Fracasso, "The Covid-19 Crisis, Italy and Ms Merkel's Turnaround: Will the EU Ever be the Same Again?", *European Network for Economic and Fiscal Policy Research.* Accessed November 4, 2021, https://www.econpol.eu/publications/policy_report_25

3 Ch. Lagarde, Tweet, 1:08AM 19 March 2020, *Twitter*. Accessed October 29, 2021, https://twitter.com/lagarde/status/1240414918966480896

4 L. Bayer et al., "France, Germany propose €500B EU Recovery Fund," *Politico.* Accessed January 3, 2022, https://www.politico.eu/article/france-germany-propose-e500b-eu-recovery-fund/

year after the start of the pandemic, to reach an EU-level agreement on joint fiscal measures.[5] While the size of the package was limited, the agreement to launch cross-border transfers and joint borrowing was important due to its allegedly symbolic nature. At the same time, as was the case during the sovereign debt crisis, the joint European fiscal response was diluted by conditionality, which remained a key feature aiming to contain the perceived moral hazard risks. By way of comparison, it is important to note in this context that even the conservative International Monetary Fund (the initial role model for the ESM) relied during the pandemic on rapid financing mechanisms (extended to more than 80 countries) without any traditional conditionality attached.[6]

The focus of this paper is to explain how the ECB's crisis management role has evolved in the context of the decisions taken by the European policy makers and why the ECB made the so-called “U turn” in the initial stage of the pandemic. The first and second parts of the paper discuss ECB President Lagarde's communications during the initial and subsequent stages of the crisis, the relevant decisions taken at the political level and how institutional architecture has remained fundamentally unchanged, despite many political innovations. In the third part, by employing the unified synthetic framework it will be argued that the ECB's crisis management role was influenced by the same independent variables as those during the sovereign debt crisis: the pressure from the crisis management mechanism and pressure from the sovereign debt markets.[7] In addi-

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5 Ch. Michel, “Remarks by President Charles Michel after the Special European Council 17–21 July 2020,” *European Council.* Accessed January 3, 2022, https://www.consilium.europa.eu/en/press/press-releases/2020/07/21/remarks-by-president-charles-michel-after-the-special-european-council-17-21-july-2020/

6 International Monetary Fund, *World Economic Outlook Database*. Accessed October 29, 2021, https://www.imf.org/en/Publications/WEO/weo-database/2021/October/select-country-group

7 M. Bernatavičius, “Independence of the ECB and the ECJ during the Sovereign Debt Crisis: From Active Leadership to Rubber-Stamping?”, *Journal of Common Market Studies* 59, Issue 3 (2021): 483–496.

tion, contrary to some authors,[8], [9] and to some extent others,[10] claiming that the COVID-19 crisis paved the way for a major institutional innovation in the euro area, it will be argued in the paper, that the basic features of the Maastricht economic governance framework remained unchanged. As well as political and institutional backdrop for the subsequent ECB's interventions. It will also be argued that, notwithstanding the different conclusions of some authors,[11] the euro area has reinforced its implicit emergency powers in the area of economic policy under the auspices of the ECB with the implicit control mechanism exercised by the euro area governments. This mechanism is manifested in the context of potentially large unintended costs related to the decisions taken by the independent institution (e.g., the ECB's decision not to cut emergency liquidity during the Greek sovereign debt crisis, which could have resulted in the disintegration of the euro area). The paper shows, that the synthetic approach[12] could also be applied explaining how the ECB's emergency crisis roles were set during COVID-19 crisis.

8 A. Camous and G. Claeys, "The Evolution of European Economic Institutions during the COVID-19 Crisis," *European Policy Analysis* 6, Issue 2 (2020): 328–341.

9 L. Bonatti and A. Fracasso, "The Covid-19 Crisis, Italy and Ms Merkel's Turnaround: Will the EU Ever be the Same Again?", *European Network for Economic and Fiscal Policy Research.* Accessed November 4, 2021, https://www.econpol.eu/publications/policy_report_25

10 N. Scicluna, "Integration through the Disintegration of Law? The ECB and EU Constitutionalism in the Crisis," *Journal of European Public Policy* 25, no. 12 (2017): 1874–1891.

11 Ch. Kreuder-Sonnen, J. White, "Europe and the Transnational Politics of Emergency," *Journal of European Public Policy*. Accessed October 29, 2021, https://www.tandfonline.com/doi/abs/10.1080/13501763.2021.1916059?journalCode=rjpp20

12 M. Bernatavičius, "Independence of the ECB and the ECJ during the Sovereign Debt Crisis: From Active Leadership to Rubber-Stamping?", *Journal of Common Market Studies* 59, Issue 3 (2021): 483–496.

1. Lagarde’s corona blunder or brutal manifestation of Maastricht institutional reality?

When the COVID-19 pandemic struck Europe, there was an urgent need to react and contain its negative economic effects, as was a case in other major monetary jurisdictions at that time. On March 12, a day after the World Health Organization (WHO) declared the COVID-19 outbreak a pandemic,[13] the ECB Governing Council approved a solid monetary policy package of additional liquidity for banks and a new envelope of additional net asset purchases of €120 billion until the end of the year. However, during the press conference explaining those decisions, the ECB President also mentioned that “*we are not here to close spreads. This is not the function or the mission of the ECB. There are other tools for that, and there are other actors to actually deal with those issues”*. [14]

The sovereign debt markets reacted very negatively, pushing the southern European bond spreads north. This episode ended in an unprecedented decision to organise an additional interview by the President after the conference, clarifying her previous comments.[15] In addition, the ECB launched its Blog the following day, in which its chief economist Philip Lane further clarified the analytical framework of the monetary policy decisions.[16] This episode received very negative coverage in the media; journalists called it “Lagarde’s co-

13 World Health Organization, WHO Director-General’s opening remarks at the media briefing on COVID-19, 11 March 2020. Accessed November 4, 2021, https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020

14 Ch. Lagarde, “Introductory statement to the press conference”, 12 March, *ECB*. Accessed October 24, 2021, https://www.ecb.europa.eu/press/pressconf/2020/html/ecb.is200312~f857a21b6c.en.html

15 M. Clinch, “ECB’s Lagarde walks back Comments Which caused Italian Bond Yields to spike.” Accessed October 28, 2021. *CNBC*, https://www.cnbc.com/2020/03/12/ecbs-lagarde-walks-back-comments-which-caused-italian-bond-yields-to-spike.html

16 Ph. R. Lane, “The Monetary Policy Package: An Analytical Framework,” 13 March 2020. *The ECB Blog*. Accessed October 29, 2021, https://www.ecb.europa.eu/press/blog/date/2020/html/ecb.blog200313~9e783ea567.en.html

rona blunder",[17] or "a gaffe".[18] Reportedly, she even apologised in a private meeting with her colleagues from the rest of the ECB Governing Council.[19] However, taking into account the institutional setup of the euro area, one could also argue that this episode was just a manifestation of architectural weakness and the lack of union-wide instruments to deal with shocks of this nature, similarly, as was a case during the sovereign debt crisis.

While the President's comments caused a spike in bond yields, she did not factually provide any incorrect information. The ECB has indeed no responsibility for closing the bond spreads. Its main task is to maintain price stability in the euro area. While the initial market reaction was contained, the long-term interest rates remained elevated in subsequent months (Figure 1). When the economic and monetary union was created, financial markets stopped differentiating between euro area member states, and bond yields started to converge, forming a unified euro area yield curve. The situation changed during the sovereign debt crisis, as markets realised that there was a lack of political consensus among member states to build a more solid institutional architecture.

The Maastricht economic governance framework for the euro area had a so-called "no bailout" clause and left fiscal policy to be governed at the national level, underpinned by fiscal rules. Joint borrowing and a common budget were not envisaged at that time. Despite this half-built institutional structure, markets remained confident that risks in the bond markets of the currency union members were more or less the same, despite different economic fundamentals. However,

17 P. Taylor, "Lagarde's Corona Blunder," *Politico.* Accessed October 28, 2021, https://www.politico.eu/article/christine-lagarde-corona-blunder-ecb/

18 C. Stirling, "Lagarde's Gaffe puts ECB Chief in Elite Club for Market Stumbles," 14 March 2020, *Bloomberg.* Accessed October 26, 2021, https://www.bloomberg.com/news/articles/2020-03-14/lagarde-s-gaffe-puts-ecb-chief-in-elite-club-for-market-stumbles

19 M. Arnold, "Christine Lagarde apologizes for Botched Communication of ECB Strategy," *Financial Times*. Accessed October 28, 2021, https://www.ft.com/content/ce39716e-66c0-11ea-a3c9-1fe6fedcca75

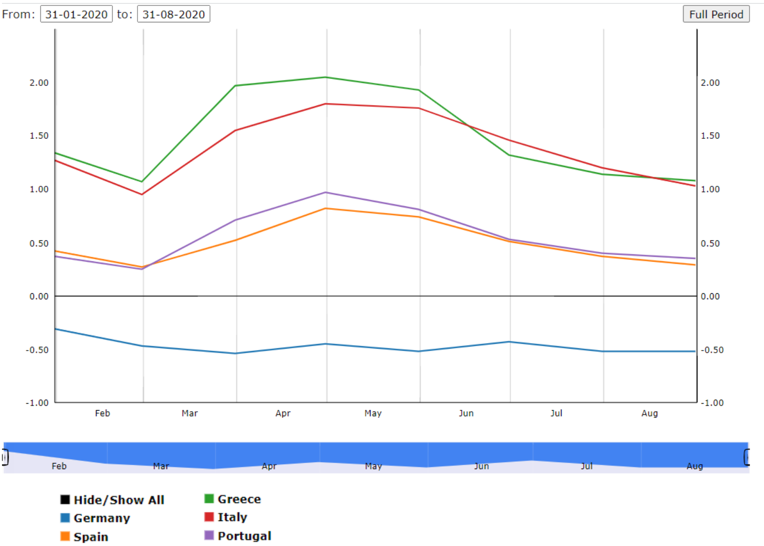

Figure 1. ***Long-term interest rates (Germany, Spain, Greece, Italy, Portugal, January 2020 – August 2020).***

Source: ECB’s Statistical Data Warehouse: https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/long_term_interest_rates/html/index.en.html

this implicit fiscal shield provided by euro area membership proved to be elusive during the Global Financial Crisis. While the “no-bail-out” clause has never been abandoned, European policy makers created the European Stability Mechanism including a “lender of last resort” function for euro area governments. The Global Financial Crisis and the ensuing European sovereign debt crisis clearly demonstrated that sovereign risks within the euro area are different, and that the contagion risk is real. The spread between German and Italian bond yields remained, despite policy innovations, verbal interventions, and an exceptionally accommodative monetary policy during the COVID-19 crisis. The positive impulse from the asset purchase programmes is dissipating as the economic recovery strengthens, and the ECB needs to react to mounting inflationary pressures and normalise monetary policy. This means that, in the medium term, the role of the markets will return as the main disciplinary force, as was originally envisaged in the Maastricht framework. In this context, one could disagree with some authors arguing that the EU economic constitution has been changed.[20]

According to some authors,[21] the most fundamental change during the sovereign debt crisis was that the ECB assumed a role of a de facto lender of last resort for sovereigns after the sovereign debt crisis. The first most obvious criticism of this claim would be the example of the creation of the ESM (which was specifically created to take lender of last resort function in the euro area). However, as the experience during the pandemic showed, the ESM was too small to help larger member states, and the perceived too intrusive policy conditionality during the sovereign debt crisis created a "stigma", which was particularly prominent in Italy. "Stigma" means that some member states are afraid to ask for the ESM's help, fearing it would be counterproductive due to the potentially negative signalling to markets. This could indicate that the ESM could be at best a lender of last resort only for smaller member states. In this context, the ECB's crisis management role was again in the spotlight during the pandemic.

While the ECB's policy actions during the pandemic contained tensions in the markets before it was too late, it would not be an exaggeration to claim that the ECB still lacks the genuine function of a lender of last resort for sovereigns. From the normative perspective, the ECB managed (again) to successfully convince markets that it had this function. However, more detailed analysis shows that the ECB's actions largely and implicitly depended on decisions taken at the political level, as was the case with the prominent Outright Monetary Transactions Programme, which, according to its technical

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20 M. Ioannidis, "Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis," *Common Market Law Review*, Issue 5 (2016): 1237–1282.

21 P. De Grauwe, "The European Central Bank as Lender of Last Resort in the Government Bond Markets," *CESifo Economic Studies* 59, no. 3 (2013): 520–535. Accessed 10 October 2021, https://academic.oup.com/cesifo/article/59/3/520/281810/The-European-Central-Bank-as-Lender-of-Last-Resort

characteristics, could only have been activated together with an active ESM programme (on which there is a need to reach unanimous agreement between all euro area member states, which usually takes time and is not the best to deal with market pressures in short term).

Similarly, during the pandemic, it was not possible for the ECB to drop its fundamental limits to bond purchases, such as the limit to the overall envelope, to the duration, and the commitment to respect the ECB’s capital key with regards to debt share in the stock of asset purchases by any member state. The aim of avoiding moral hazard was one of the most important Maastricht economic governance principles. The theoretical possibility for the ECB to buy all the outstanding sovereign debt of any member state (and in effect neutering the disciplinary role of the markets) was ruled out despite publicly communicating that there would be “no limits” to ECB’s actions. At the same time, some media commentators and market participants over-interpreted the ECB’s commitment to flexibility in its asset purchase programmes,[22] declaring that the ECB had dropped limits to asset purchase programmes.[23] Interestingly, despite its fundamental significance, this issue received little attention during the President’s regular press conferences after the ECB Governing Council’s monetary policy meetings: from the start of the pandemic up until January 2022, it was mentioned only three times by journalists. The latest comment by President Lagarde on this topic was that “*the asset purchase programme can stand on its feet very well, and it’s a programme that has played a key role, that continues to play a key role, and that there was no need to actually modify in any shape or form*”.[24] This statement implied that,

22 European Central Bank, “Decision (EU) 2020/440 of the European Central Bank of 24 March 2020,” *Official Journal of the European Union.* Accessed January 4, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020D0440#ntr1-L_2020091EN.01000101-E0001

23 M. Arnold and T. Stubbington, “ECB shakes off Limits on New €750bn Bond Buying Plan,” *Financial Times.* Accessed January 4, 2022, https://www.ft.com/content/d775a99e-13b2-444e-8de5-fd2ec6caf4bf

24 Ch. Lagarde, “Monetary Policy Statement press conference,” 16 December, 2021. *ECB*. Accessed January 4, 2022, https://www.ecb.europa.eu/press/pressconf/2021/html/ecb.is211216~9abaace28e.en.html

since the start of the pandemic asset purchase programme, there had been no need to change the self-imposed limits and, thereby, to undermine the fundamental economic governance principles of the common currency area.

The incomplete Maastricht framework has received multiple attacks from the markets during the sovereign debt crisis and the pandemic. As a union-wide interest group, sovereign debt markets created clear functional pressure for a spillover effect into fiscal policy. In this context, constraints related to national politics created "political spillback",[25] which limited the political feasibility of finishing the institutional architecture. These constraints related to national politics remained in place during the pandemic, despite policy innovations such as the NGEU package, which was agreed and presented as a one-off measure. While one could argue that this package created an important precedent for the future, it has not changed the basic principles of the Maastricht framework in the long term.

When the COVID-19 pandemic struck, economic scars from the Sovereign Debt Crisis were still prominent, economic policy buffers had not been fully rebuilt and euro area governments found themselves in different fiscal positions. In Germany, after strong growth in the 2010s, policy makers managed to reduce their public debt levels below the Maastricht 60 percent criterion, while most southern European countries accumulated their debts further, hovering around 100 percent of GDP. It was clear at that time that lockdowns would cause unprecedented economic recessions and an unprecedented rise in sovereign debt levels, which also resulted in significant negative revisions to the Spring 2020 economic outlook.[26],[27] It was just a matter of time be-

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25 R. Vilpišauskas, "Eurozone Crisis and European Integration: Functional Spillover, Political Spillback?", *Journal of European Integration* 35, no. 3 (2013): 361–373.

26 International Monetary Fund, "World Economic Outlook, April 2020: The Great Lockdown." Accessed January 4, 2022, https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020-

27 European Commission, "European Economic Forecast. Spring 2020." Accessed January 4, 2022, https://ec.europa.eu/info/publications/european-economic-forecast-spring-2020_en

fore financial markets started to incorporate this information into the pricing of sovereign bonds. The infamous intervention by Lagarde at the start of the pandemic was a trigger but was by no means the main cause of the spike in bond yields. Considering the incomplete euro area institutional architecture, pandemic related lockdowns and the lack of political consensus to concentrate on a joint fiscal response, European policy makers had very few union-wide policy options left. As was the case during the sovereign debt crisis, the ECB increasingly looked like the "only game in town",[28] at least during the initial phase of the crisis.

2. "Whatever it takes" 2.0?

As it was argued in the previous section, the pandemic shock has demonstrated, that the euro area's institutional architecture remained too weak to address the magnitude of the challenge. As pressure from the sovereign debt markets intensified, the ECB was forced to use its first line of defence: communication. On 18 March 2020, just before midnight, after long discussions at the Governing Council, the ECB announced an additional monetary policy measure: a new Pandemic Emergency Purchase Programme (PEPP), under which the ECB committed to buying 750 billion euros of public and private sector securities.[29] While the announcement of the new programme was important in itself, ECB President Lagarde added in a public statement that "*there are no limits to our commitment to the euro*".[30] After this announcement, the euro area bond spreads remained contained in the upcoming months (Figure 1). Despite the initial criticism to the Lagarde's pandemic crisis response and communication, discussed in the previous section (which was implicitly related to the incomplete

[28] M. El-Erian, "The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse," *Random House LLC* (2016).

[29] European Central Bank, "ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP)," *ECB*. Accessed October 29, 2021, https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html

[30] Ch. Lagarde, Tweet, 1:08AM 19 March 2020, *Twitter*. Accessed October 29, 2021, https://twitter.com/lagarde/status/1240414918966480896

institutional architecture), this episode (Lagarde's comment that "there are no limits") could be interpreted as Lagarde's "whatever it takes" moment. It bought time for European policy makers to find a longer-term response to the crisis.

The comparison with Mario Draghi's famous intervention is not an exaggeration. A few days before the second "whatever it takes" moment, Lagarde was humble about her potential role: "*I don't have a claim to history for being whatever-it-takes number two. I really would like all of us to join forces, and I very much hope that the fiscal authorities will appreciate that we will only deal with the shock if we come together*".[31] In the context of the unfinished institutional architecture, the ECB's interventions could be credible only in the short term. As history shows, Draghi's "whatever it takes" intervention was so successful because it created the illusion that it was up to the ECB to solve the fiscal crisis: the ECB conditioned its potentially unlimited intervention in the sovereign bond market of any member state on the need to have an active ESM programme. Similarly, the second "whatever it takes" announcement came with an illusion, namely, that there are no limits to potential ECB interventions. This worked initially, but as time went by it became clear that the fundamental limits embedded in the ECB's asset purchase programmes would remain in place. The second "whatever it takes" moment, like its predecessor, only bought time for policy makers to find a political way out of the crisis.

As was the case during the sovereign debt crisis, the Maastricht economic governance framework was not fundamentally changed during the pandemic. The role of the markets was further reinforced, despite tighter spreads, as euro area leaders failed to finish the institutional foundation of the common currency area. The so-called "Hamiltonian" moment has not been reached,[32] as there was no agreement

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31 Ch. Lagarde, "Introductory statement to the press conference," 12 March, *ECB*. Accessed October 24, 2021, https://www.ecb.europa.eu/press/pressconf/2020/html/ecb.is200312~f857a21b6c.en.html

32 A. Camous and G. Claeys, "The Evolution of European Economic institutions during the COVID-19 Crisis," *European Policy Analysis* 6, Issue 2 (2020): 328–341.

on either the mutualisation of the outstanding debt or permanent transfers to supranational institutions with substantial taxation powers. After the ECB intervention, it took almost half a year to reach agreement on the joint European fiscal response. While the cumulated subsidy part of the NGEU package (genuine cross-border transfer) might look impressive by European standards, for the biggest beneficiary countries – Italy and Spain – it constitutes only around 1 and 2 percent of their cumulative GDP over the plan’s operational period.[33] It should be further clarified, that if one would like to calculate the additional annual fiscal impulse, it would be significantly less that one percent and therefore not macroeconomically relevant. The significant part of the deal was the agreement to add conditionality for accessing those funds (cross-border transfers and loans). Whether this will be a successful policy endeavour will depend on its implementation. For the time being, one could argue that the ECB’s “whatever it takes” medicine has been working again. In this context, what are the factors explaining why the ECB navigated to its second “whatever it takes” moment, despite the initial challenges? What were the roles assumed by the ECB during these two episodes of the crisis? From the academic and practical points of view, these are important questions that could be explained by employing the unified synthetic approach of classical integration theories. For that purpose, all relevant ECB’s public communication will be analysed since the start of the pandemic.

3. From proactive leadership to agent of the principal

Due to the unique institutional architecture of the euro area, there is no lack of “competition” between different integration theories in academic debates, trying to explain the main drivers of integration. Classical integration theories such as neofunctionalism and liberal intergovernmentalism, as well as new branches such as the princi-

[33] IMF WEO database, 2021.

pal-agent model or new institutionalism are the most prominent examples of such attempts. While these theories could well explain some decisions taken during the pandemic, the unified approach[34] could be more helpful in trying to shed more light on important nuances, which are sometimes omitted in all-encompassing academic debates, as some theories, as the neofunctionalism, are good to explain the short term policy responses, while others, like liberal intergovernmentalism – the longer term perspective. The model, which employs both, such as a unified approach, helps to better explain how the crisis management roles of independent institutions such as the ECB were set and changed over time.

Table 1. ***Roles assumed by independent institutions during the sovereign debt crisis and main determinants***

		Risk of contagion (pressure in the sovereign debt markets)		
		Low	*high*	
Pressure from the Crisis Management Mechanism	Low/ *high*	**Business as usual**	**Proactive leader**	
	High/ *low*	*Rubber-stamper*	**Implicit agent of the principal**	Principle of proportionality
		Passive stance	Proactive stance	

Source: Bernatavičius, M. "Independence of the ECB and the ECJ during the Sovereign Debt Crisis: From Active Leadership to Rubber-Stamping?", Journal of Common Market Studies, Volume 59, Issue 3 (2021): 483–496, with modification proposed by the author. At the start of the COVID-19-related economic crisis, the ECB has moved

[34] M. Bernatavičius, "Independence of the ECB and the ECJ during the Sovereign Debt Crisis: From Active Leadership to Rubber-Stamping?", *Journal of Common Market Studies* 59, Issue 3 (2021): 483–496.

from the “business as usual” role towards the “proactive leader” role (black arrow pointing right), as the risk of economic contagion and the pressure in the sovereign debt markets become more prominent (moved from “low” to “high”). Later, when the initial pandemic-related economic uncertainty stabilised, initial concerns related moral hazard within the currency union had to be contained (black arrow pointing down) and the safeguards (limits/constraints) towards the ECB’s policy action become more prominent in order not to undermine the crisis management mechanism developed by governments of the euro area member states (the pressure from the crisis management mechanism moved from “low” to “high”, the same black arrow pointing down). During the COVID-19 the ECB did not have to assume the “rubber-stamper” role (blurred) proposed in the original paper.

In the unified approach (Table 1), the two main independent variables determining the roles of independent European institutions (such as the ECB) were the union-wide pressure from the sovereign debt markets and the pressure from the crisis management mechanism, or the policy of conditionality (loans for reforms). While the decisions taken during the pandemic were interpreted as significant, or even “Hamiltonian”,[35] one could also argue that the underlying institutional architecture[36] has not been changed during the pandemic, as well as the crisis management mechanism, or the preferred policy of conditionality.

The so-called German U-turn on cross-border transfers (grants) underpinned by joint borrowing was interpreted as an important, or “historic”, step towards deeper integration (and a vindication of neofunctionalism). Some authors even argued that the EU “will never be the same again”.[37] However, looking deeper, it can be seen that the size of the approved package was macroeconomically limited. One could also argue that it was not really unprecedented or “historic”: as

35 The Barron’s Daily, “Europe’s Hamiltonian Moment.” Accessed October 28, 2021, https://www.barrons.com/articles/europes-hamiltonian-moment-51595334081

36 Maastricht framework underpinned by national-level fiscal policy, fiscal rules, and the disciplinary role of the markets.

37 L. Bonatti and A. Fracasso, “The Covid-19 Crisis, Italy and Ms Merkel’s Turnaround: Will the EU Ever be the Same Again?”, *European Network for Economic and Fiscal Policy Research.* Accessed November 4, 2021, https://www.econpol.eu/publications/policy_report_25

ESM/EFSF lending was also based on joint borrowing, together with an implicit grant component via lower interest rates compared to the conditions in the market at the time of borrowing from the EFSF/ESM. The main principle, which helped to legitimise those transactions, was the conditionality: loans could only be extended subject to the effective implementation of reforms and fiscal consolidation.

During the pandemic, European policy makers took one unusual step compared to their sovereign debt crisis response (without undermining the overarching conditionality principle) and agreed to extend not only loans but also a grant component in exchange for reforms. This happened after realisation that the size of the ESM and its conditionality might not be the best solution for bigger euro area member states such as Italy. While the ESM was also active during the pandemic and expanded its lending toolkit by introducing a pandemic credit line with basically no conditionality attached,[38] its pitch has not been successful. As of January 2023, no country has asked for financial assistance: the stigma associated with the potential ESM programme might also have played some role here. In this context, another important point worth noting was the low interest rate environment – largely an outcome of the ECB decisions discussed above that significantly expanded the fiscal space in all euro area member states and reduced the need to look for alternative sources of financing. The suspension of the Stability and Growth Pact (SGP) rules created an environment allowing member states to utilise this additional fiscal space without the need to respect stringent fiscal rules. Paradoxically, this suspension reinforced the Maastricht's institutional status quo by allowing more fiscal action at the national level without undermining the fiscal framework. The prospect of a radical reform of SGP rules after its reactivation does not seem a very likely outcome going forward, as the need to change the rules had been discussed many times before without any meaningful result due to diverging political preferences.

38 European Stability Mechanism, "ESM's role in the European response," *ESM*. Accessed November 4, 2021, https://www.esm.europa.eu/content/europe-response-corona-crisis

Interestingly, the euro area was not alone in tweaking its approach during the pandemic. The IMF, which was a pioneer of the “loans for reforms” principle and the primary example for Europeans in their creation of the sovereign debt crisis management architecture, also changed its operational model during the pandemic. In a very short period of time, the IMF extended loans under the pandemic window to more than 80 countries without applying its standard conditionality.[39] While during the pandemic the European model retained the “conditionality” part of the bargain, a symbolic “grant” component was also added to the package.[40]

Since the European crisis management model remained fundamentally unchanged despite the tweaks described earlier, the unified synthetic approach is very helpful in trying to provide a better explanation of the ECB’s role during the pandemic. One could argue that the ECB was again the indispensable institution in addressing pandemic-related economic challenges. Its proactive role was still at odds with the theory of new institutionalism,[41] which claims that EU independent institutions should be interpreted as “de novo bodies” with issue-specific and relatively narrow mandates. While the ECB was again not alone in solving the crisis, it was indispensable in having at its disposal means to react in a very short time.

As the crisis management mechanism has been slightly tweaked during the pandemic, the underlying feature of the Maastricht framework – the containment of moral hazard – remained prominent. The basic logic of its features is to avoid any incentives that could encourage member states to offload risks from their policies to the union level. This could happen during periods of very accommodative monetary policy, which could blur disciplining signals from the sov-

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39 International Monetary Fund, “COVID-19 Financial Assistance and Debt Service Relief,” *IMF*. Last updated on 27 October 2021. Accessed November 4, 2021, https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker

40 The IMF also extended grants to lower income countries via various debt relief initiatives.

41 Bickerton et al., “The New Intergovernmentalism: European Integration in the Post-Maastricht Era,” *Journal of Common Market Studies* 54, Issue 4 (2015): 703–722.

ereign debt markets. In the proposed model, when the independent institution assumes a proactive role in a period of high pressure from the sovereign debt markets, moral hazard concerns could be created. In the medium term, member states step in with their own actions and independent institutions could start emphasising safeguards to their proactive leadership role: reducing concerns related to moral hazard and becoming the implicit agents of the principals, which wanted to preserve the crisis management mechanism, as other solutions, such as genuine fiscal integration, were not politically feasible.

During the initial phase of the pandemic, while presenting the measures of the more accommodative monetary policy, ECB President Lagarde added that it is not the task of the ECB to close the spreads. At that time, pressure from the markets and the crisis management mechanism was low. The ECB decided to ease its monetary policy as the pandemic increased risks of lower inflation. In addition, a stronger reaction would have strengthened moral hazard concerns. Therefore, the ECB assumed a "business-as-usual" role at that time, despite widespread criticism in the media and negative reactions in the markets. This was also the case during the sovereign debt crisis, when the ECB hesitated to assume a more proactive role in the initial stage of the crisis.

While there is no doubt that the ECB has in principle unlimited financial firepower, the unfinished institutional framework and concerns related to moral hazard act as an important constraint on the ECB's actions. When union-wide pressure in the sovereign debt markets intensifies, the euro area governments need time to find politically feasible means to contain the crisis, so the ECB steps in and reluctantly assumes a proactive leadership role in the short term. This does not unconditionally suggest that the ECB was "the only game in town" during the crisis.[42] A better explanation is that the ECB needs to step in to contain the pressure in the sovereign debt markets in the short term in order to give euro area governments time to find con-

[42] M. El-Erian, "The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse," Random House LLC (2016).

sensus at the political level. The ECB’s proactive leadership role is not sustainable due to the concerns related to moral hazard. Another important argument in this context is related to the proportionality of the ECB’s actions.[43] The ECB could only use its emergency powers after applying the proportionality principle: an implicit cost vs benefit rationality. In this context, one may disagree with some authors claiming that there are no emergency powers at the EU level.[44],[45] At least in the economic governance area, there are clear emergency powers at the ECB’s disposal with an implicit control mechanism processed by the euro area member states.

Even before the announcement of the ECB’s Pandemic Emergency Purchase Programme, limits to asset purchase programmes were an important monetary policy topic, as the previous asset purchase programmes had not been finished at that time. The ECB knew that, however substantial the overall amount of the new asset purchase programme would be, markets would start to question at what point the self-imposed limits would allow the programme to contain tensions in the sovereign debt markets. In this context, without discussing limits explicitly, the ECB decided to tackle this issue by applying a policy of deliberate ambiguity. The same method was used in 2012, when Draghi delivered his most famous “whatever it takes” speech. After the announcement of the Pandemic Emergency Purchase Programme, ECB President Lagarde published an additional post on her social media claiming that there were no limits to the ECB’s commitment to the euro. Without providing any further details, it created the illusion that, if need be, the ECB could drop its self-imposed

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43 Y. Mersch, Keynote speech at the Natixis Meeting of Chief Economists, Paris, 23 June, *ECB*. Accessed October 10, 2021, https://www.ecb.europa.eu/press/key/date/2016/html/sp160623.en.html

44 S. Auer and N. Scicluna, “The Impossibility of Constitutionalizing Emergency Europe,” *Journal of Common Market Studies,* early view. Accessed October 29, 2021, https://onlinelibrary.wiley.com/doi/10.1111/jcms.13240

45 Ch. Kreuder-Sonnen and J. White, “Europe and the Transnational Politics of Emergency,” *Journal of European Public Policy*. Accessed October 29, 2021, https://www.tandfonline.com/doi/abs/10.1080/13501763.2021.1916059?journalCode=rjpp20

constraints and intervene in the sovereign debt markets without any limits.

In the context of deliberate ambiguity, it is very important to analyse the simultaneous decisions taken at the political level. While according to some contributions, Merkel's so-called U-turn on cross-border transfers with joint borrowing (May 18, 2020) was taken in the context of a negative decision by the German Constitutional Court on the ECB asset purchase programme (May 5, 2020), this reasoning is not fully convincing. Firstly, no legal challenge related to the ECB's policies from the German Constitutional Court had been fully successful in the past and there was no immediate risk to the ECB's role. Secondly, the European leaders realised that, despite the positive effect of the ECB's "whatever it takes" 2.0 in the bond markets, the stability provided by deliberate ambiguity could not be a long-term solution, and there was a need to act on the fiscal front as well (as it was evident in still elevated long term interest rates, Figure 1). While ECB President Lagarde claimed that there were "*no limits to our commitment to the euro*", that statement was intentionally ambiguous, as the limits, related to the Pandemic Emergency Purchase Programme remained in place. The cancelation of these limits would have been a clear breach of the spirit of the Maastricht economic governance framework. Paradoxically, the need to safeguard the main Maastricht principles was the fundamental reason for the Merkel–Macron symbolic agreement on cross-border grants and joint borrowing in May.

As is shown in the model (Table 1), the ECB's starting position was the "business as usual" role. This means that under these conditions there was no pressure in the sovereign debt markets or from the crisis management mechanism, so there was no need to activate emergency powers. After President Lagarde's first intervention about spreads, the union-wide pressure in the sovereign debt markets started to build up, pushing the ECB to activate its emergency measures and assume the "proactive leadership" role (black arrow heading east in the model (Table 1)). The same logic was applied in 2012, during the first "whatever it takes" intervention. However, the "proactive leadership” role for an independent institution such as the ECB is not a sustainable choice, since the risks related to moral hazard become more and more prominent. The time between the start of the emergency intervention and the reaction from the political level (black arrow heading south) is the time “bought” by the ECB to find a more sustainable political solution to the crisis. Without such a solution, any positive effect from the “proactive leadership” role dissipates, pushing the independent institution to assume the “implicit agent of the principal” role, as concerns related to moral hazard and, therefore, the pressure from the crisis management mechanism (policy of conditionality) become more prominent. Based on the principal-agent framework, the agent should be constrained and controlled by its principal. While the ECB is legally independent institution, the agent (in this case, the ECB) cannot be directly and legally controlled by anyone. The ability to control in this case could only have been exercised implicitly: as the ECB was not in a position to take political decisions in the long run it has had to develop the constraints/safeguards to its policies based on the decisions taken at the political level. This transition was apparent after the first “whatever it takes” moment, when the ECB had to clarify that one of the main conditions for its intervention was the active ESM programme with effective implementation of policy conditionality. During the second “whatever it takes” moment, the ECB had to clarify that there was no need to change limits to asset purchase programmes.

While in this paper the role of “rubber stamper” proposed in the model has not been discussed and remains blurred (Table 1), it might prove to be very important going forward when the monetary policy stance will be recalibrated to contain building inflationary pressures as the economy recovers from the unprecedented pandemic. The spreads could start widening again and there might be a need for measures at the member state level rather than union-wide actions. Whatever further modifications to the crisis management mechanism might be agreed, the ECB could again find itself in the spotlight, as there might be a need to support the strategy taken at the political level and assume the "rubber stamper role" seen in 2015 when the ECB did not object to extending emergency liquidity provision for Greek banks.[46]

Conclusions

The two most prominent episodes during the pandemic generated strong reactions in public debates and the markets. The first, related to ECB Lagarde's intervention claiming that it was not the ECB's task to close the bond spreads, was met with comments calling it a policy gaffe or her biggest mistake. This was an exaggeration: while it is hard to disagree that the intervention was received very negatively in the markets, the fundamental reason for it was the lack of policy instruments at the union level to deal with such shocks, which was clearly not the area of the ECB's remit. Another Lagarde intervention claiming that there are no limits to the ECB's commitment to the euro was arguably underrated, probably because it was published only a couple of days after the so-called biggest communication mistake.

Almost ten years after the sovereign debt crisis, some euro area economies had not fully recovered and the pandemic struck them unprepared. It was not possible to fix the roof in the pouring rain, and European policy makers relied on the same medicine: a proactive crisis management role assumed by the ECB ensuring some breathing space on the fiscal front. While European policy makers managed to reach an agreement on symbolic cross-border transfers and joint borrowing, the Maastricht institutional framework was not fundamentally changed, and the disciplinary role of the markets has been preserved.

The ECB was in a "business as usual" role when it declared that it was not its business to close the bond spreads: there was no significant pressure from either the sovereign debt market or from govern-

46 M. Bernatavičius, "Independence of the ECB and the ECJ during the Sovereign Debt Crisis: From Active Leadership to Rubber-Stamping?", *Journal of Common Market Studies* 59, Issue 3 (2021): 483–496.

ments via the crisis management mechanism. Afterwards, when tensions in the markets started to build up, the ECB took the very bold decision to launch the Pandemic Emergency Purchase Programme, which came with a very strong public intervention by President Lagarde. This could be interpreted as the second “whatever it takes” moment, with the ECB managing to create a convincing illusion, or a deliberate ambiguity, that its interventions are limitless. Later, when the short-term positive effect started to dissipate and concerns related to moral hazard started to bite, the ECB acknowledged there was no need to modify limits to its purchase programmes, thus implicitly taking on the “agent of the principal” role.

European policy makers kept conditionality in their crisis management mechanism as the main tool to ensure and control the effective use of common funds. Effective implementation of the NGEU package will be crucially important, as the economic recovery will create the need to normalise economic policy. Normalisation could result in significantly higher bond yields, especially for high-debt countries if they struggle to increase their productivity growth to escape the debt spiral. This potentially negative economic equilibrium could further increase functional pressure on fundamental reform of the Maastricht framework. At the same time, if progress with reforms under the NGEU proves to be slow, it will be even more challenging to build a political consensus on the need for reform of the Maastricht framework. As European policy makers have not yet reached a “Hamiltonian moment”, the factors that might lead to real institutional reform of the monetary union instead of relying once again on the crisis management mechanism, merit further research. The unified approach is helpful to avoid some misconceptions of the functioning of the euro area and the crisis management role of independent institutions, such as the ECB. This approach proved to be helpful to better understand and explain the reaction functions of the euro area’s independent institutions.

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